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RESPONSE TO NSSD-2-85:

ECONOMIC DEVELOPMENT FOR CENTRAL AMERICA (U)

I. Introduction

The troubled situation in Central America has no single cause, but poor economic performance over the past few years has been a major contributing factor to political instability. Since 1979, the region has experienced a steady decline of per capita income, a decline of regional trade, the loss of international credits and foreign investment, and the erosion of private sector business confidence resulting from domestic economic, political and security problems. (C)

To reverse this trend, the Kissinger Commission called for substantially increased military aid to meet the problem of externally-assisted insurgency in El Salvador and greatly expanded economic assistance to improve the quality of life of the people and encourage democracy, and support essential structural economic transformation. (U)

U.S. economic aid to the friendly Central American states is an integral element of our response to the current crisis in the region. Our response is driven, in the first instance, by a potential threat to the security of the United States. In its report, the Kissinger Commission identified the issue precisely: "the intrusion of aggressive outside powers exploiting local grievances to expand their own political influence and military control is a serious threat to the U.S., and to the entire hemisphere." (C)

At the same time, military, political and economic objectives cannot be viewed independently of each other. Humanitarian interests as well cannot be underemphasized as a motivation for giving aid. As the Commission observed, "the requirements of Central America are a seamless web. The actions we recommend represent an attempt to address this complex interrelationship in its totality, not just in its parts." (U)

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The U.S. response is comprehensive:

-- military aid to meet the externally-assisted insurgency in El Salvador and reinforce the security posture of the "Core Four" states;

-- diplomatic efforts to fashion a workable settlement to conflict in the region; and

-- economic assistance to promote economic and social progress to improve the lot of the people, encourage democracy and decrease the probability of destabilizing discontent. (U)

The crisis in Central America is regional. It cannot be treated solely through assistance to one or two countries. (U)

In implementing the economic recommendations of the Bipartisan report, Secretary Shultz has called for a development strategy that works through an open economy, one that rewards initiative, investment and thrift. Four key elements include:

- First, growth should be based primarily on domestic savings and investment, requiring the retention of capital domestically;
- Second, foreign and domestic investment should receive equally fair treatment;
- Third, foreign resources should be used to supplement domestic savings, not to supplant them. Too strong a reliance on foreign assistance or foreign capital can foster dependence and undermine productivity; and
- Fourth, trade must be the engine of development. Domestic economies that are open to international competition can raise this standard of living. (U)

Progress in economic policy reform and the buildup of U.S. economic assistance to Central America over the past several years -- which culminated with the appropriation of the first tranche of the Kissinger Commission recommendations last August -- have begun to yield positive results on both the economic and political fronts. A vicious circle of worsening economic conditions and political instability was halted in 1984, when the region had positive economic growth for the first time in five years. This improvement in economic prospects has been accompanied by an encouraging movement toward democracy in the region. (U)

Nevertheless, the region's economic, social and political problems have not yet been resolved. Unemployment and underemployment have grown. The debt burden is high. Export revenues depend upon only a few basic commodities. Large public sector deficits are commonplace. Levels of infant mortality and illiteracy are unacceptably high. In short, the crisis continues and, as pointed out by the Kissinger Commission, sustained economic growth in Central America is a long-term process requiring difficult policy changes and a sustained high level of support from the U.S. (U)

Our analysis indicates that major improvements in basic economic and social conditions in Central America are possible over the medium term if policies are improved and complemented by an appropriate U.S. foreign assistance program. Chart 1 summarizes the major goals that we believe can be achieved by 1990. (U)

CHART 1

MAJOR GOALS OF THE CENTRAL AMERICAN INITIATIVE (U)

Target Concern	1984 Level	1990 Goal
GNP Growth Rate	1.2%	5-6%
Agricultural Production Growth Rate	0%	4%
Manufactured Exports to the U.S.	$314 Million	$950 Million
Infant Mortality (per 1,000)	65	50
Primary School Enrollment (%)	80	95
Family Planning Prevalence (percent of fertile women)	24%	40%

The purpose of this NSSD is to assess progress to date and to provide an analytical framework for implementing U.S. objectives toward economic development in Central America in support of U.S. national security policies. It aims to:

-- analyze economic prospects over the medium and longer term;

-- review economic assistance and U.S. interests in Central America; and

-- present a framework for monitoring progress toward achieving economic objectives. (C)

II. Central America - the Economic Backdrop (U)

During the past few years Central America has been buffetted on the economic front. Since 1978, the region has experienced a decline of regional trade, the loss of international credits and foreign investment, and the steady erosion of private sector business confidence resulting from domestic economic, political, and security problems. (C)

From a regional standpoint, the adverse events of recent years have been mutually reinforcing. Indeed, political turmoil and economic development problems are interrelated. For example, political instability and inappropriate economic policies in the face of the adverse external environment have combined to cripple economies in a number of ways:

-- Insurgency has seriously damaged much of the productive infrastructure in several countries. Even now, road transportation, electrical transmission systems, and dams are regular targets of the insurgents.

-- Compromising economic policies that provide a short-term cushion for political expediency have fueled inflation and discouraged investment in export and other industries.

-- Political instability and intransigent economic problems, coming at a time of global financial difficulty, have made the region too risky to attract external financial flows.

-- Intimidation of rural workers, especially in El Salvador, has reduced the traditional movement of laborers among farming regions, cut harvests sharply, and boosted food import needs.

-- An unfavorable economic environment and political instability have spurred capital flight to safe havens in the United States and elsewhere.

-- Depressed economies and the real prospect of physical violence have greatly reduced tourism, another source of foreign exchange.

-- Intraregional trade has fallen off rapidly, particularly within the Central American Common Market (CACM), which had been the basis for the region's nascent industrial development. (C)

III. Economic Growth -- Short and Medium Term (U)

After steadily declining over the 1979-83 period, gross national product in the Central American countries we are supporting grew in 1984 by 1.2%. Chart 2 summarizes recent growth. Improvements in policy and U.S. assistance were critical to this turnaround -- helping to stabilize the financial situation and to increase confidence in political stability. This is demonstrated by the trend in short-term private capital movements. The substantial capital flight that occurred during 1980-82 has been checked, and private funds

Encouraging Signs of an Economic Turnaround in Central America

Chart 3

Short-Term Private Capital Movements

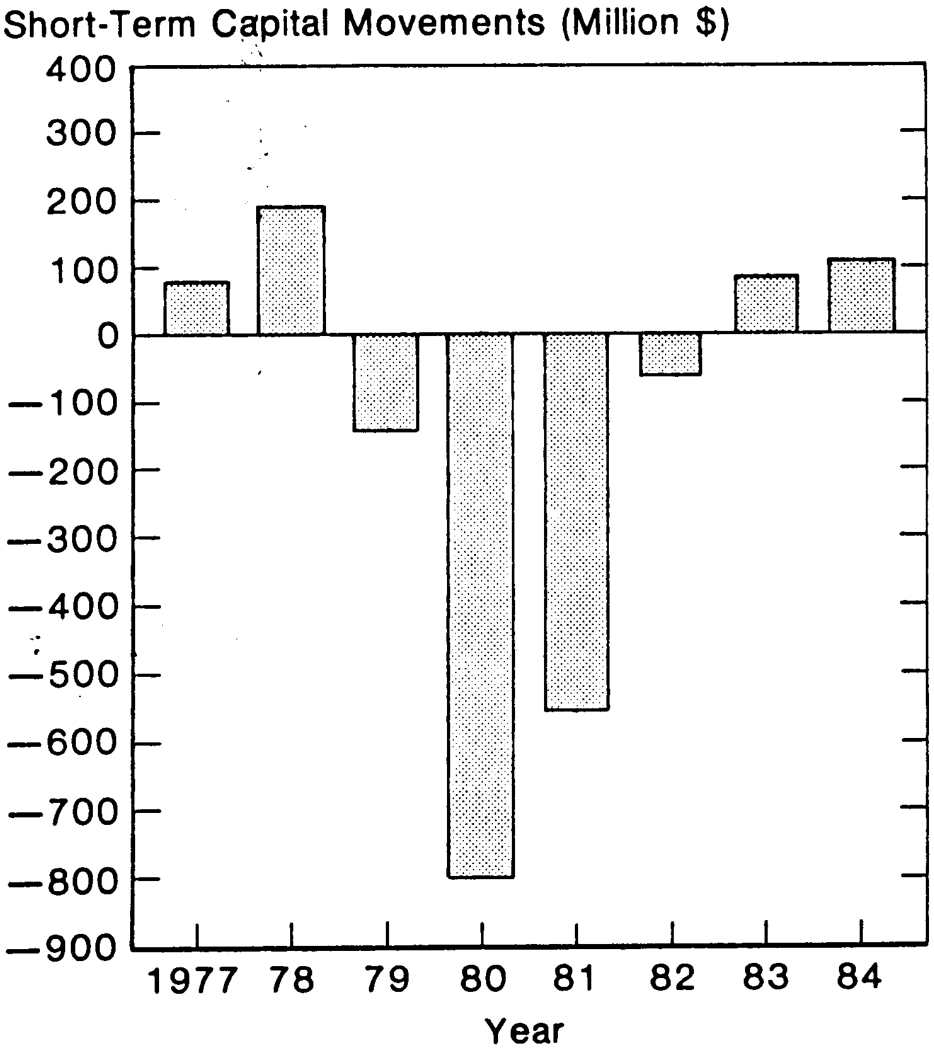
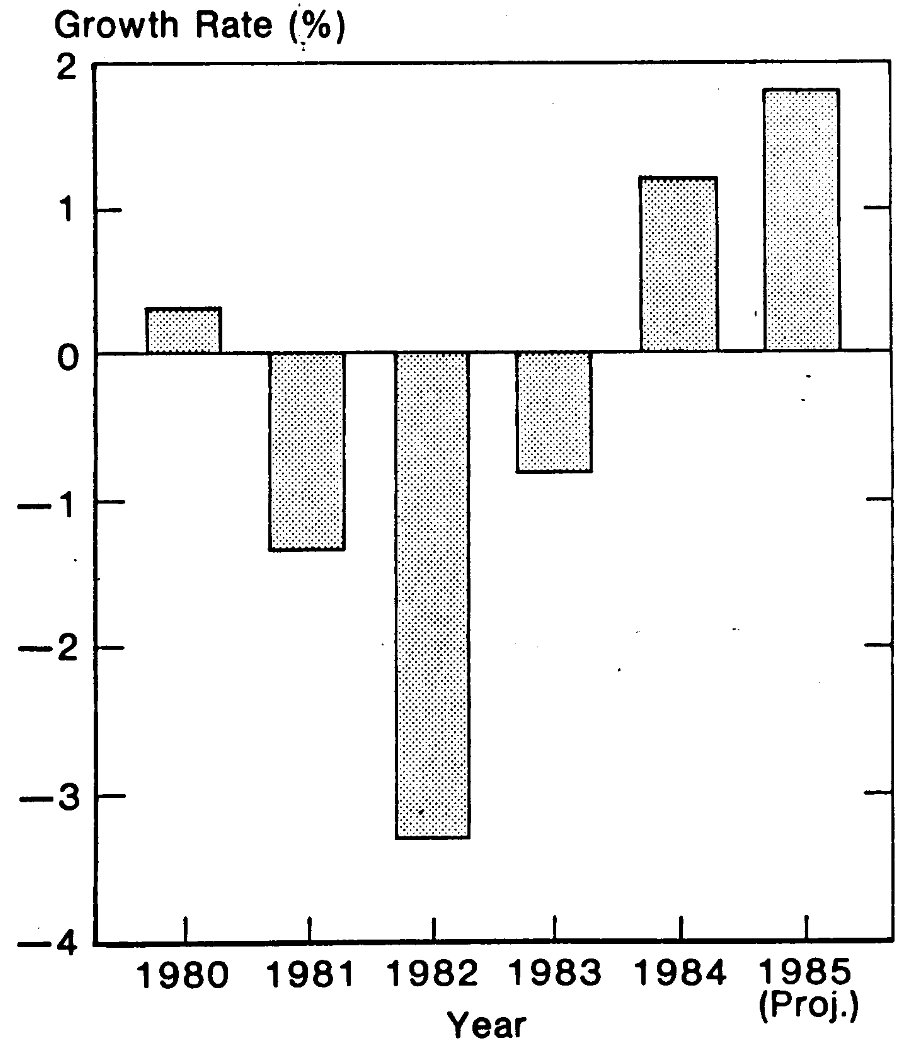


Chart 2

Growth in GNP



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began to flow back into several countries in 1983 and 1984 (see Chart 3).

This improvement in economic conditions in Central America will only be temporary unless structural changes in their economies lead to economic growth. To assure a proper climate for long-term growth, we have sought to link our assistance to economic policy improvements by the governments we are assisting. A good start has been made in some countries:

-- exchange rates in Costa Rica, El Salvador and Guatemala have been realigned to encourage exports;

-- government budgets have been reduced and fiscal deficits have been cut in Costa Rica;

-- government controls inhibiting private sector investment have been reduced in all countries; and

-- governments are actively considering divestment of inefficient public enterprises through sale to the private sector, particularly in Costa Rica and Panama. (C)

In charting a course for the future, it is important to take into account the international economic conditions that will directly and indirectly affect the economies of Central America. Among the external conditions Central America will face, Western economic growth is the most important. At present, most forecasters expect annual OECD growth to be from 3 to 4 percent during the period, and even higher in the United States, Central America's main market. Nonetheless, given current policies, this is not enough to substantially boost the region's export earnings because demand for agricultural commodities, which constitute nearly three quarters of the region's exports, are relatively unresponsive to growth in the industrial countries. (C)

Indeed, despite record 6.9 percent economic growth in the United States in 1984, exports by the region to the United States rose by less than 10 percent, while sales to the United States from the rest of the world were up 30 percent. Moreover, even if OECD growth is unexpectedly high, there is likely to be a lag of about two years before such growth shows much effect on commodity prices. Without some increase in the price of agricultural commodities, export earnings may even fall as businesses, such as the multinational banana producers, decide to cut their losses and leave the area, as has already occurred in Costa Rica. (C)

The key to faster export growth, then, is changing Central America's export base, and this in turn depends on improving policies to encourage the private sector to develop new products. In some cases necessary policy reforms, complemented by CBI incentives, are already having an impact.

Exports of non-traditional products from Central America to the U.S. were up sharply in 1984. Such products can become an important source of export earnings and employment in the medium term. (C)

Besides these two major determinants of Central American export growth -- OECD growth and policy reform -- a number of secondary factors can also play an important role. Export growth to the United States has been weak in part because foreign producers and U.S. importers have been slow to react to CBI incentives. Part of this was because the interim customs regulations that were in effect during the first ten months of the CBI were extremely hard to use. Of the major non-petroleum and non-traditional exports from the region, only exports in the category of "sugar, syrups, and molasses" used the CBI preference for more than one-third of shipments, and most Central American exporters virtually ignored the CBI preference in favor of the GSP and the general U.S. import schedule. (C)

There is hope for increases in exports from the region under the CBI preference. Most importantly, the customs regulations that discouraged use of the preference have been replaced by more functional rules. Beyond this improvement, the opportunity presented by the U.S. market for non-traditional sales of produce and fruit from Central America during the U.S. off-season is enormous, and has given rise to plantings of truck garden vegetables, cut flowers, annual quick-maturing fruits, and citrus products (which take several years to reach market). (C)

Moreover, emphasis on increasing exports through promotion of private sector investment in labor-intensive agricultural and industrial enterprises is crucial. All countries assisted by the U.S. Government have undertaken steps to encourage exports (e.g., information systems, simplification of forms, access to foreign exchange, preferential credit access reduction of import tariffs). Partly as a result, exports of non-traditional products from Central America to the U.S. were up sharply in 1984. Such products can become an important source of export earnings and employment in the medium term. Assuming the insurgency situation continues to improve, Central American exports of manufactured goods can replace bananas as the second largest export grouping by 1990. So far, a number of specific promotion activities (e.g., vegetables, free-zone investments) supported by AID show encouraging results. (C)

As far as internal factors are concerned, the most important are the state of regional insurgency and the local policy climate in individual countries. On the first score, the status largely depends on the position the Sandinista government takes toward regional aggression. As far as the policy climate is concerned, the debate will be between improving the investment climate and market place versus protecting urban consumers and other politically-powerful groups. Before private investors -- foreign or domestic -- will make a commitment to Central America's future they must be convinced that the government can sustain favorable policies. We expect it will take two or more years of demonstrable policies and political peace before investment would pick up appreciably, especially so long as profitable and less risky ventures exist in other regions of the industrial and developing world. (C)

IV. Economic Growth -- The Longer Haul (U)

While preliminary data suggests that aggregate economic growth picked up in 1984, the CIA estimates that with an absence of appropriate local policies and enhanced foreign financial flows would almost certainly result in real growth that is unlikely to exceed 2-3 percent annually for the region as a whole over the next several years. This GNP path, which assumes OECD growth in the 3 to 4 percent range, would, of course, not be enough to stem the decline in living standards or create anywhere near the number of jobs needed to satisfy the demands of the expanding labor force. For regional leaders trying to regain political stability and steady economic development, this would mean even harder times ahead for Central America's 22 million people. (C)

Given this, it is clear that getting back to the economic performance of 1961-1978 would require substantial policy reform supported by a high level of external resources. The Kissinger Commission report estimated that the six countries would need a strong commitment to economic reform and some $20 billion in net foreign capital inflows through 1989 to gradually boost their aggregate economic growth to the 6 percent range. This would raise per capita income growth to about 3 percent by 1988 and largely return personal consumption to peak 1979 levels by 1990. (U)

As the Kissinger Commission noted, however, this prognosis is highly sensitive to economic and political developments. Specifically, it requires that:

- -- projected financial flows materialize;
- -- domestic economic policies are improved; and
- -- regional security is achieved and maintained. (U)

If these conditions fail to be met, it is almost certain that growth will fall short of the rates projected by the Commission. As it is, the setting of regional peace assumed by the Commission has failed to emerge and is unlikely to materialize in the future as long as Managua continues to march down its current policy path. Furthermore, the pace of economic reform has been somewhat slower than originally hoped. This has had a double impact on Central America prospects. First, resource inflows are reduced as financing associated with economic reforms -- IMF and some IBRD lending, new bank money, direct investment, and official reschedulings -- is not forthcoming. Second, the resources which are available are less efficiently used, and growth suffers. (C)

It is extremely difficult to make long term projections with any confidence. Nevertheless, given the aid and policy moves to date, the region's economic performance will likely range somewhere between a 2 percent steady-state growth path and the more optimistic Kissinger scenario. Under the assumptions that: (1) U.S. net financial flows to the region run $1.3 billion per year; (2) the Central American countries maintain the economic policy changes taken to date; (3) IMF programs are not phased in; and (4) instability remains a problem, an economic growth path that returns per capita GNP to its 1978 level by 1995 is not unrealistic. Under such a scenario, the CIA estimates that the rate of real GNP growth might approach 5 percent early in the next decade. (S)

Moving above this middle scenario is, of course, possible. From an internal standpoint, there are steps that Central American governments can take to help foster growth and improve the economic climate. Appropriate exchange rates, for example, will help make exports more competitive and allocate imports more efficiently. Likewise, the elimination of overly protective tariffs will reallocate domestic resources away from inefficient uses. Growth-oriented credit and tax policies, coupled with sustainable government budget positions, will aid in improving savings and investment flows, which in turn will underpin economic resurgence. In this regard, an appropriate foreign investment climate can only help. An additional area in which local policies can stimulate growth focuses on inefficient use of state firms. If the size and control of these state enterprises can be pared, the range of possibilities for private sector involvement -- be it local or foreign -- will further open. Furthermore, improved policies supported by IMF programs would increase financial flows to the region by 30%. In addition to local economic policy moves, achieving a strong growth performance will hinge critically on peace within the region. If Managua, for example, opted to shift for a policy that ensured true regional peace, the multiplier effect of U.S. aid would be greatly enhanced. In such a setting:

-- New and existing economic infrastructure would be safe from insurgent attacks;

-- Foreign and domestic entrepreneurs would be more willing to invest in the region;

-- A rebound in regional trade -- particularly in the manufacturing sector -- would boost local business; and

-- Such an environment would be conducive for a return of at least some flight capital as well as a generation of an increased level of domestic savings. (S)

If such changes occurred, the region would likely see its growth trajectory rise until the pace of economic activity began to approach the level envisioned in the Kissinger report. (C)

These three alternative growth scenarios can be summarized as follows (see Chart 4):

High Growth: A combination of high levels of U.S. aid, major reforms in local economic policy and a reversal of Managua's aggressive regional stance could provide rapid economic growth. This outcome would require a strong commitment to market-oriented policies to stimulate financial flows and to private investment, particularly in non-traditional export sectors. (C)

Moderate Growth: A combination of high levels of U.S. aid, inadequate economic reforms, and political instability will lead to only moderate growth in per capita incomes. The lack of stabilization programs would reduce net financial flows from other agencies, including debt rescheduling. (C)

Low Growth: Without the Jackson Plan U.S. assistance, a continuation of current policies would be likely to lead to a continued downhill slide in per capita income. Because of the likely political unrest and poor economic climate, potential foreign investors or commercial lenders would be generally unwilling to provide resources to the region, and capital flight would continue. (C)

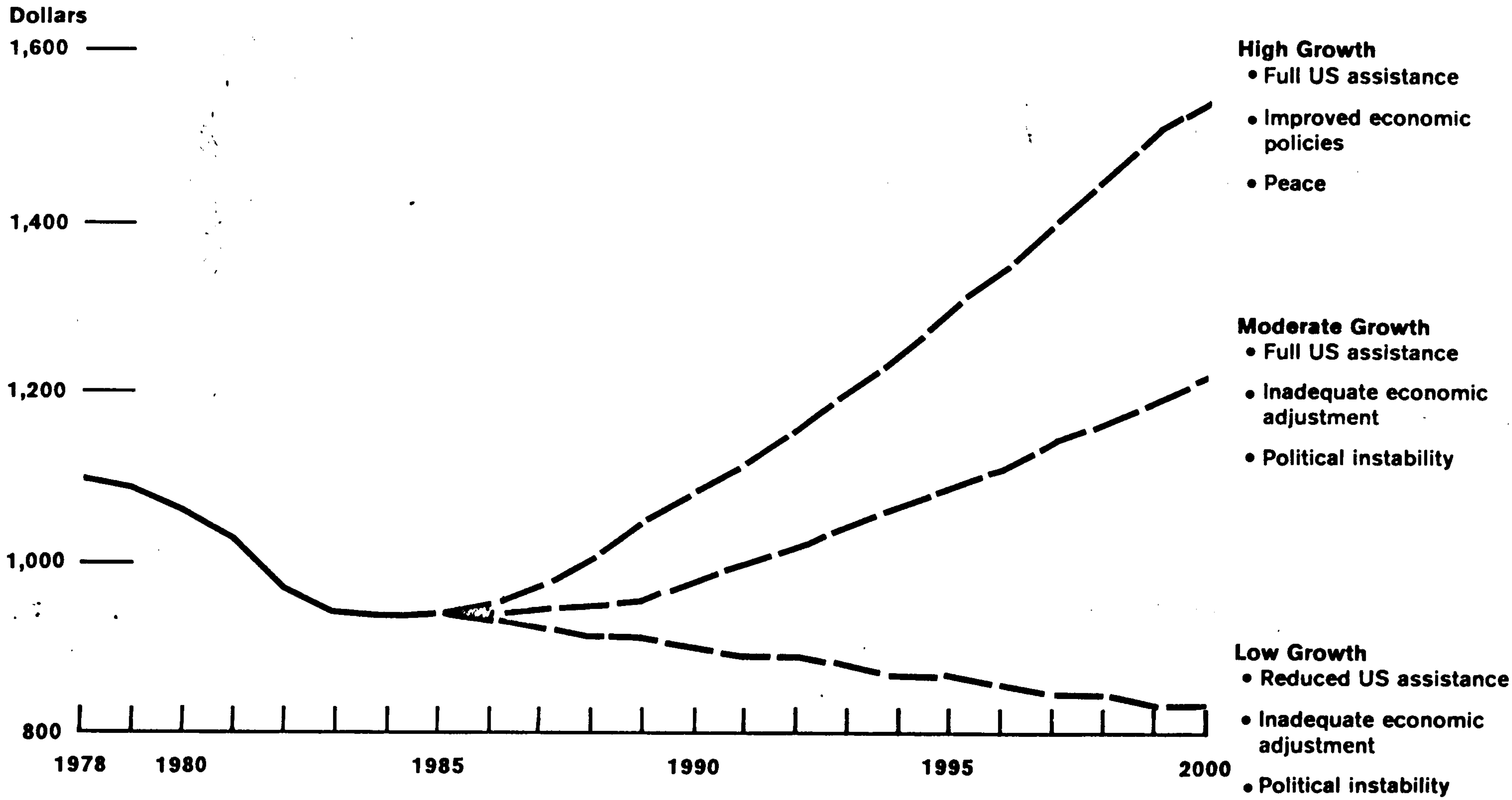
V. Economic Growth: The Human Aspects (U)

At a more personal level, the difference in possible growth rates translates directly into jobs and changes in living standards. As it is, studies show that in El Salvador, Guatemala, and Honduras about half the urban population and three quarters of the rural residents could not meet their basic needs for nutrition, shelter, and health care. While urbanization and industrialization, especially in the mushrooming cities, created some new middle class citizens, the gulf between rich and poor remained or widened. (C)

Unemployment problems have worsened in each country, and are at critical levels in El Salvador and Honduras. While the population explosion of the 1960s is now pouring 250,000-300,000 Central Americans into the labor force each year, few new jobs have been created during the past six years. As a result, the bulk of new job entrants are unemployed or underemployed. Official estimates place the rate of unemployment in the region at about 20 percent, with some 1.3 million workers without jobs. Nearly half those with jobs in

Chart 4

Central America: Per Capita Income Trends



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El Salvador, Honduras, and Guatemala are underemployed because they can find only seasonal and part time jobs. (C)

Economic growth will help reverse these trends, reinforced by efforts now under way to broaden the distribution of the benefits of growth are under way. Land reform in El Salvador has been supported through our assistance. Progress in building up the base of education and health in the poorer Central American countries -- Honduras, El Salvador and Guatemala -- is being made, but improvements will require long-term efforts. Projects based on the recommendations of the Kissinger Commission are being developed and funded, but success in these areas will require improvements in institutions that can only occur gradually over time. An important step in the institution-building process is strengthening of human resources through higher education. A Central American scholarship project based on a Kissinger Commission recommendation has been approved for this purpose, and the first entrants into U.S. training should begin before June, 1985. (C)

The quality of life is not simply limited to health care and jobs. Considerable progress has been made over the past several years toward strengthened democratic institutions. Only Costa Rica has had a solid tradition of democratic government in the region, but significant positive progress has occurred in each of the other countries supported by U.S. assistance. El Salvador and Panama have both completed democratic elections for president after a decade or more of military rule. Guatemala, where a constituent assembly has been writing a new constitution, may make this transition later in 1985. In Honduras, a democratically-elected government is expected to complete its term next January and turn power over to another democratically elected government -- the first peaceful transition of power in three decades. (C)

An important element of U.S. support for strengthened democracy in Central America is assistance for the improvement in the administration of justice. AID has been working with the Government of El Salvador in this area, and a regional project to provide the same kinds of training, advisory services and support to other governments in the region is now being developed. (C)

VI. <u>Projected Financial Flows to Central America, 1985-89</u> (U)

Projections of financial flows to Central America for the period 1985-1989 illustrate the importance of comprehensive economic adjustment programs in the six countries. We estimate $13 billion in net financing will flow to the region if there is economic reform supported by IMF programs throughout the period. However, this amount drops sharply to $9 billion, if these six countries choose to forego IMF programs. Central America will lose IMF resources of about $615 million and an additional $3.4 billion of financing associated with IMF programs. In the absence of IMF programs, we assume no Paris

Club reschedulings, no net new commercial bank lending, no IBRD structural adjustment loans, and reduced foreign direct investment flows. We assume that the regional political situation for both scenarios will see some improvement over the five-year period. (C)

Net U.S. government financial assistance to the six countries, assuming adoption of IMF programs, will essentially meet the Kissinger Commission target of $8 billion. Without IMF programs, USG financial flows drop by over $1.4 billion to $6.6 billion, because Paris Club reschedulings will not be available. (C)

The U.S. Government is the major source of financing to the region throughout the period -- providing 61% of total flows, followed by the multilateral financial institutions (including IMF) with 17%, and other official bilateral flows providing 10%. This assumes: (1) IMF Standby programs for three of the five years; (2) Paris Club reschedulings of payments due official creditors; and (3) commercial bank reschedulings of principal and some modest net new bank lending of $1 billion over the period. (Costa Rica and Panama account for $600 million of this.) We have also made the optimistic assumption that commercial bank willingness to reschedule will be unaffected by the absence of IMF programs. (C)

In the absence of IMF and linked financial flows, the USG share rises to 75% and the multilateral share (including IMF) drops to 13%. The already limited role of commercial financial institutions (8%) decreases to 3%. (C)

It should be noted that even with new IMF programs over the period, net flows from the IMF are negative because of high utilization of IMF resources by Central American countries over the past five years. However, outflows to the IMF would be considerably higher in the absence of new IMF programs. (C)

The share of other official bilateral sources of financing assuming adjustment to the region remains small throughout the period. Without Paris Club reschedulings, however, the share of other bilateral flows is almost halved. Disaggregation shows that a large part of bilateral funds come from Mexico and Venezuela, not Europe or Japan. (C)

Finally, even assuming economic adjustment measures, the $13 billion we estimate in total net financial flows to the region is only about 60% of what the Kissinger Commission estimated as necessary to reach target economic growth rates. (C)

VII. Economic Assistance and U.S. Interests in Central America (U)

Based on the diagnosis of the Kissinger Commission Report, the U.S. Government has developed a four-pronged strategy for Central American development:

Economic Stabilization: The essential first step -- for which $2.6 billion is programmed -- is to provide financial assistance to end the decline in production, incomes and employment by allowing continued imports of necessary raw materials and intermediate goods. This assistance buys time for the governments of the region to establish a sustainable development strategy. (U)

Economic Transformation: The second step (requiring $1.7 billion in U.S. assistance) is to promote the transformation of the region's economy to a self-sustaining basis. Production of labor-intensive agricultural and industrial products for export markets provides the best hope for creating this kind of economic dynamism. Implementation of an export-led growth strategy requires a variety of changes in government economic policy. The most important of these is a broadening of opportunities for the private sector through ending of excessive regulation and use of market forces to provide appropriate incentives. Exchange rates are particularly important in stimulating increased exports. Major investments in productive enterprises and in economic infrastructure are also needed. Development of indigenous energy resources is also critical to relieve the burden of oil imports. (U)

Broadening the Base: In some countries of Central America -- notably Guatemala, El Salvador and Honduras -- a restoration of economic growth is not sufficient to achieve our goals. The disparities in income and opportunity are so wide within those countries that a more direct attack on such problems is needed. We have established a series of specific goals, including increasing primary school enrollments to all primary-aged children, sharply reducing infant mortality, increasing access to modern family planning, and improving access to agricultural technology, that address these goals. Programs have been designed and are being implemented to carry them out. We have programmed $1.7 billion for this purpose, not including $1.2 billion in local currency counterpart generations from the balance of payments assistance. (U)

Democratic Institutions: A number of actions are under way to promote democratic institutions in the region, including strengthening of judicial administration, support for fair elections and strengthening of understanding of U.S. institutions through scholarships for U.S. education. A total of $0.3 billion in activities in this area have been programmed. The support for scholarships is a particularly noteworthy element of the Kissinger Report, which calls for 10,000 scholarships for U.S. study during the next five years. This program, which was induced in part by the large numbers of

Soviet-bloc scholarships for study in Soviet-bloc countries, is under way, with candidates now being selected for entry into U.S. universities later this year. (C)

Altogether, the cost of implementing the four elements of the program is $8.4 billion, including $6.4 billion in appropriated funds and $2 billion in guarantees. The mix of funding requirements gradually changes over the five-year life, with stabilization assistance receiving the bulk of funding in the early years, followed by a later phase-over to support for economic transformation. (C)

VIII. The Criteria for Economic Aid

The total amount available for the region is set both by our estimate of the need (e.g., balance of payments gaps, capacity for absorption of aid) and the constraints of the U.S. domestic budget process. Allocation among the countries of the region must reflect the level of resources needed to achieve economic growth (or at least prevent economic deterioration), and each nation's willingness to cooperate with us on the overall goals, both political and economic, that will ensure security. The relative levels of aid should not necessarily be interpreted as absolute rankings of the importance of each Central American country to the U.S. (C)

Our experience since the initiation of the Central America Initiative illustrates the criteria for allocation of economic aid.

-- El Salvador and Costa Rica received the largest shares of the total because their economies were in the greatest danger of collapse, El Salvador because of the ongoing insurgency and resulting damage to its economy, Costa Rica due to critical foreign exchange shortages caused by the problems of servicing a massive foreign debt.

-- We have judged that democratic Costa Rica also deserves continuing support to reward its progress, most significant of all in the region, in adopting and implementing the type of free-market reforms we advocate for sustained economic growth.

-- Honduras, highly cooperative on security matters, has received less economic aid because it has demonstrated a lower potential to take necessary economic reform measures.

-- Our aid to Guatemala has been constrained by Congressional concerns over the human rights record of the current military government and a reluctance to take adjustment measures.

-- Assistance to Panama and Belize have increased markedly under the Central America Initiative, albeit less than to the Core Four because of less immediate need, higher living standards in Panama and lower absorptive capacity in Belize.

-- Nicaragua, of course, receives no U.S. economic aid because of its continuing and growing relationship with the Soviet bloc and its adoption of marxist and state controlled economic policies. Should these circumstances change, our aid policies and requirements would change accordingly. (C)

IX. What We Get For Our Aid: The Issue Of Economic Conditionality (U)

The imposition of conditions or guidelines on the use of U.S. economic assistance is mandated by our responsibility to ensure that the assistance promotes, rather than delays, an economic foundation for political and social stability. As U.S. Government financial assistance increases, we must avoid making economic growth dependent on massive inflows of U.S. aid. We have no desire to create dependencies. On the contrary, our interest in long-term stability in the region -- in returning Central American problems to Central American dimensions, in the words of the Kissinger Commission -- requires that we ensure that the region prepare for the day when U.S. assistance markedly declines or terminates.

-- Linking our aid to economic reforms -- conditionality -- is the principal tool we have to see that this goal is accomplished. (C)

As the Kissinger Commission noted, "in too many other countries, the increased availability of financial resources has undermined reform by relieving the immediate pressure on policymakers. This must be avoided in Central America." (U)

The development of appropriate conditionality for U.S. assistance must take into account the local political and security situation. Sometimes these objectives come into conflict.

-- U.S. policymakers need to make careful assessment of, and conscious decisions about, the likely consequences for various interrelated U.S. objectives, including political and economic stability, bilateral cooperation, and security interests, of imposing more or less rigorous conditions (or of withholding and/or reprogramming aid). (U)

Rigorous conditions designed to set the stage for the improved economic growth and employment prospects and the revitalization of the private sector over the medium-term, may be perceived as threatening by incumbent governments. They can cause severe internal disruption and strain our bilateral relations. Such strains may be sufficiently severe to undermine a principal motive for our aid: elimination of the potential threat to U.S. security. (C)

Conversely, delaying economic adjustment exacerbates the underlying economic problems, requiring larger and more dramatic adjustment efforts down the road. This may translate into calls for greater levels of U.S. Government resources with less conditionality as imbalances and capital flight worsen and other sources of finance, particularly routine trade financing, dry up. If our assistance levels cannot keep pace in cases of ever-increasing dependency, the risk of economic stagnation and resulting instability will increase. (C)

-- The policymakers' task, therefore, is to fashion an assistance program with conditionality that maximizes the chances for achieving the desired economic results without unacceptable damage to other objectives. (U)

We must provide a basis for cooperation on military and security requirements consonant with economic objectives. Conditionality on balance of payments support, particularly ESF, is often the most effective and appropriate tool for accomplishing macroeconomic policy reforms to bring about economic stabilization and ensure sustainable growth. At the same time, our insistence on conditionality has sometimes strained relations and diluted the political benefits of ESF support. (C)

X. Options for Conditionality

Our general policy has been to use U.S. balance-of-payments assistance to encourage negotiation and compliance with comprehensive economic stabilization programs, often supported by IMF standbys. (U)

-- The development of, and compliance with, comprehensive economic-stabilization programs are the optimal way to ensure the successful application of U.S. financial assistance toward the objective of sustainable growth. (U)

IMF-supported comprehensive stabilization programs have several substantial advantages over a strictly bilateral approach. The IMF provides significant financial resources of its own and opens the way for a Paris Club rescheduling of debt to official creditors. An IMF program may also stimulate IBRD structural adjustment loans and increased financial flows from other donors and commercial banks. (U)

Until recently, our ESF balance of payments assistance programs in Central America were tied, at least initially, to compliance with comprehensive adjustment programs in the form of existing IMF standby arrangements. Some difficulties have arisen with this approach. (C)

-- First, the countries of the region have had difficulty maintaining their relations with the IMF. (Only Belize currently has an operating Standby, although Costa Rica is expected to receive Board approval soon, and Panama's negotiations with the Fund may result in a Standby in the next few months. El Salvador's standby program expired at the end of 1982 and Honduras fell out of compliance in mid-1983.) (C)

-- Second, measures taken by governments to achieve the principal IMF Standby objective of restoring balance of payments equilibrium in the short run may not always precisely coincide with other U.S. objectives. (C)

-- Finally, implementing strict linkage to IMF programs has been complicated by the Kemp-Kasten amendment to the FY 84 supplemental aid bill and FY 85 Continuing Resolution, prohibiting the withholding of economic assistance disbursements solely based on the policies of multilateral institutions. The amendment reflects concern about the impact of IMF adjustment policies and the type of measures governments often choose to meet Fund targets (e.g., tax increases). (C)

While the USG has continued to disburse funds (although under different timetables and conditions) to the Central American countries in the absence of IMF programs, we do not view an indefinite absence of the IMF from the countries of the region as desirable. We should continue to encourage countries to resume an IMF-supported adjustment program. (U)

Without IMF Standbys in place, the U.S. has been forced to consider bilateral approaches to conditionality, or suspend disbursements until the Fund relationship was restored. The bilateral approach does not replace the substantial resources lost from the IMF and other sources because of the lack of a standby arrangement, or provide the basis for sustained growth. But it does have the advantage of continuing the policy dialogue and support for policy reforms. It minimizes the loss of momentum in the adjustment process, although it places extra stress on bilateral relations. (C)

Several alternatives to IMF-supported economic reform have been considered and/or employed in Central America over the past two years. The first retains as its objective adoption of a comprehensive adjustment program without an IMF standby designed to remove impediments to sustainable, non-inflationary growth (e.g., overvalued exchange rate, overly protective tariffs, excessive government deficits, extensive inefficient public sector). When we develop a "shadow program" independent of the Fund, our efforts to enforce directly comprehensive conditions by granting or holding back ESF places strains on our bilateral relationship. Moreover, U.S. Government efforts in the absence of the Fund have not produced the confidence among official and private lenders and investors necessary to sustain the same levels of external loan and investment flows. It should also be recognized, however, that Central America's peculiar socio-political situation has been another primary determinant of capital flight and reduced private investment. (C)

A second option, development of a less-than-comprehensive "short list" of specified economic reform measures, may lessen the risk of strain and confrontation because the recipient government must meet fewer conditions. However, if we wish to maintain a realistic prospect of progress toward the desired economic goals, the short list would logically include the most painful and often most politically difficult measures. The short list option, therefore, is likely to differ little in its initial political consequences from a comprehensive program, and will not mobilize financial resources from other lenders. The short-list approach may be more palatable in encouraging countries to bite one bullet at a time and, over time, allow a more distant, less obtrusive U.S. monitoring of their economic policy and performance. (C)

In situations where 1) comprehensive conditionality proves impractical because of recipient government hostility to reform and/or overriding foreign policy or security considerations, and 2) it is impossible for political reasons to reprogram the aid elsewhere, a measure of real economic impact may be preserved by converting ESF balance of payments support into projectized aid. The advantage of this approach over weak conditionality is that the assistance can be directed toward productive sectors and supporting infrastructure rather than underwriting inappropriate and potentially damaging short-term policies. This option has not so far been used in Central America. It could impose significant administrative burdens and overhead costs. It may likely be of limited value in countries where there exists a significant pipeline of undisbursed project funds. (C)

The final option is to impose no significant economic policy conditions. Under this approach balance-of-payments support is used explicitly or implicitly to offset or pay for the host country's costs of cooperation with the U.S. on security and other non-economic objectives. These costs may be considerable. Even with U.S. military assistance programs, the costs of coping with internal rebellion and economic sabotage (as in El Salvador) or of supporting freedom fighters and maintaining defense against potential aggression (as in Honduras), may be more than local budgets can reasonably bear. (C)

This strategy presents the lowest risk of short-term strain on our bilateral relationship or threat to the government in power's popularity and overall political stability. But it postpones to the future any consequences, economic or political, of distortions in the economy created by continued inappropriate policies and of the risk of increased dependence on external assistance. Furthermore, such distortions tend to worsen over time, increasing the costs, either in terms of painful internal adjustment, or of foreign assistance. (C)

Tactical Considerations for Conditionality

Any conditionality strategy implies a number of tactical decisions. The recipient country may be required to meet all conditions before any ESF funds are disbursed, or installments may be set up either for payment as each condition is progressively met or to ensure continued compliance with the program over time. The "all-or-nothing" tactic and both types of tranching have been used in the past in Central America. The projectizing option may be applied for all or a portion of the total ESF available. (C)

-- The proper mix of tactics must be determined by the peculiar circumstances of each case and our judgment of how we may best balance our overall objectives. (U)

There is scope for a range of conditionality associated with different types of assistance. U.S. assistance agreements related to concessional aid programs, Development Assistance, PL 480, and Economic Support Funds (ESF), have in the past included three types of conditions: project-related financial and technical requirements; project-related economic policy conditions; and conditions which require changes in the macroeconomic policies of the recipient country. (C)

Project conditions usually involve such issues as reorganization of implementing agencies, improvements in planning or budgeting processes, or the adoption of new technologies. The potential impact of such sectoral conditions on the balance of payments and/or host-government budgets should not be underestimated. As previously noted, balance of payments support through ESF programs have most often been used to promote broad macroeconomic policy reforms. Food and other commodity aid funded under Public Law 480 also represent balance of payments support, but conditionality associated with PL 480 aid has been primarily used to achieve significant policy modifications within the agricultural sector. (C)

The Central America Initiative also includes financial assistance from several export promotion programs and a housing-guarantee program which do not fall under the category of concessional economic assistance. These include the Trade Credit Insurance Program (TCIP), the Export-Import Bank worldwide credit-guarantee program as available for Central America, Housing Investment Guarantees (HIG) and export credit guarantees extended by the Commodity Credit Corporation (CCC). The TCIP, created to alleviate problems with U.S. trade credit flows in the region as a result of a legislative requirement that all Eximbank support provide reasonable assurance of repayment, is administered by Ex-Im Bank and backed by an ESF-funded reserve. The normal terms of Ex-Im Bank credit guarantees (other than reasonable assurance of repayment) will apply to the TCIP. Conditions linked to allocation of HIG's have been primarily related to the housing sector. (C)

CCC export credit guarantees are designed to develop and maintain markets for U.S. agricultural products by providing guarantees of commercial bank lending at market interest rates on terms of up to three years. Neither Congress nor the Executive Branch regards CCC as principally a foreign-assistance program. Because of the commercial nature of the CCC program, recipient countries are expected to provide reasonable assurance of repayment. However, the maximum three-year length of the program offers a degree of concessionality. Many foreign governments, therefore, do not make a clear distinction between CCC and bilateral economic assistance; they see CCC as another manifestation of U.S. support. The conditionality issues raised by economic assistance may in such cases apply to the granting of CCC credits. (C)

The urgency of our national security objectives in Central America and the greatly expanded level of financial assistance mobilized to achieve those objectives necessitate close coordination of the various programs in applying conditionality. (C)

-- We need to ensure that the conditions attached to our financial assistance programs are logically consistent and complement one another. (U)

We also must ensure that sectoral reforms and investment plans are consistent with the requirements of macroeconomic stability and economic liberalization. We must be flexible in our approach and eliminate pre-set notions of what are appropriate linkages between various programs and economic reforms. We must assess the impact of financial assistance carrying market terms on future economic prospects. (C)

XI. Regional Aspects of the Central America Assistance Effort

The recommendations of the National Bipartisan Commission included strong support for regional solutions to the ills of the Central American region. The Commission warned against attempts to resolve the crisis piecemeal; it asked for "local effort and external support, integrated into a comprehensive approach." The Central America Initiative incorporated the Commission's view of a regional approach in several areas funded by economic assistance, including projects on a regional basis to promote development of education, health and social services, the administration of justice and development of democratic institutions. (U)

Three major recommendations of the Commission to promote regional cooperation have not yet been implemented. They are a fund to help revitalize the Central American Common Market (CACM), a contribution to the Central American Bank for

Economic Integration (CABEI), and the establishment of a Central American Development Organization (CADO). The U.S. Government study of these three regional activities may lead to the conclusion that one or more would not represent the best use of our assistance resource or, in the light of changing circumstances in Central America, would not adequately promote the objectives attached to the regional ideal by the Commission. If this proves to be the case, we should not be reluctant to abandon any of these specific projects while maintaining the high priority in the Central America Initiative for activities appropriately pursued on the regional level. (C)

The Commission's call for regional solutions to the crisis in Central America also included a challenge to other extraregional donors and to the multilateral institutions to join the U.S. and the Central American countries in the effort. Specifically, the Commission estimated that gross flows of resources into Central America required to restore 1980 living standards in 1990 would need to total at least $29 billion by that year. The judgment that such a level could suffice was based on very optimistic assumptions about capital flight and about the Central American countries' willingness to forego consumption for investment. (C)

As the statistics developed in this study point out, the U.S. effort may fall somewhat short of the Kissinger Commission's $8 billion target. Every effort should be made to ensure that the full $8.4 billion effort over five years is implemented. In addition, friendly nations should be urged to contribute more. Only Mexico and Venezuela, through the San Jose Oil Facility, have provided resources to the region in targeted amounts. The Europeans, except for a $19 million pledge to CABEI, have so far contributed only vague promises made at last September's conference in San Jose. The World Bank has the capacity in its structural adjustment loans to provide substantially more resources, but the Central American governments except Costa Rica (and perhaps Panama) have been reluctant to consider the adjustments required to tap this source of financing, a fact that highlights the vital role which policy reform must play in achieving our objectives. (C)

-- The U.S. should increase its efforts to enlist greater support from its allies, and continue to review the lending programs of mulilateral institutions to ensure development of the region. (U)

Equally important and perhaps most critical to the prospect of sustainable growth in the region independent of official aid is the mobilization of funds for investment from private external sources, which are projected in this study to be practically non-existent throughout this decade in some Central American countries. The U.S. Government can make special efforts to bring encouraging political, security and economic developments to the attention of potential investors, but the success of our overall program to achieve peace, security and sustained growth in the region will be the primary catalyst of greater investment flows. (C)

-- Failure to achieve total resource flows near the amounts recommended by the Commission will mean failure to capitalize on the initial successes brought about by our increased assistance and close cooperation with international financial institutions. (C)

XII. Implementation, Timing and Monitoring of Assistance Programs

The implementation of the President's Central American Initiative (CAI) is one of the two top program priorities in AID. Specific program proposals are developed by AID field missions, identifying proposed uses of the funds and conditions under which assistance is provided. These program documents are reviewed in Washington by the Development Assistance Executive Committee (DAEC), an interagency group including representatives of State, Treasury and OMB. Where issues arise concerning conditionality, a policy-level committee chaired by AID Administrator McPherson and Under Secretary of State Schneider has been established to resolve them. (U)

An AID/State task force is providing guidance to the field missions on the implementation of the CAI and to monitor and evaluate progress, identify and help resolve problems and to generally expedite the implementation of the program. A two-tiered, computerized tracking system is being installed to provide the task force with up-to-date information on U.S. Government concessional assistance and to monitor progress toward the achievement of our goals in Central America. It includes two components:

-- a financial monitoring system which tracks regional and country funding data by funding source, projects, NBCCA recommendations, and fiscal years, which is ready for installation; and

-- a goal tracking system, with data on major economic and social indicators, which is expected to be on line by the end of August. (U)

Because of the program's high priority, AID has increased its staff in Central America by 34 positions, increased backstopping support for Central America in Washington, raised the authority of Mission Directors to approve projects in the field for up to $20 million, and delegated new contracting authority to the AID Regional Contracting Office. (U)

EL SALVADOR: COUNTRY PROFILE

Primary U.S. Objectives

-- Promote development of democratic institutions and the electoral process. Support dialogue and negotiations within El Salvador to expand participation in the democratic process.

-- Promote economic adjustment measures to ensure ongoing economic development.

-- Ensure that El Salvador has the means to fight an insurgency supported and often directed from abroad.

Recent Economic Performance and Prospects for Growth

-- Real GDP dropped 25 percent from 1978-82 while per capita GDP and personal consumption dropped by a third. Investment fell 45 percent in 1980 and 20 percent in 1981. Industrial production dropped 40 percent from 1978-82.

-- Economic decline was arrested in 1983, largely due to foreign assistance. 1984 growth is estimated at 1.6 per cent, supported by increased government services and a small boost in exports.

-- Economy still burdened by insurgency and lack of private sector confidence, with political violence a main deterrent to growth. Without improved security climate growth is unlikely to exceed 2-3 percent per year through the end of the decade.

-- Political and military stability combined with government policies conducive to investment and export production could lead to real per capita growth exceeding 2-3 percent.

Economic Assistance Strategy

-- Stabilize the Salvadoran economy by promoting macroeconomic policies and programs that will lay the basis for resumption of sustainable, non-inflationary economic growth and greater employment opportunities;

-- Consolidate the agrarian reform program and improve agricultural production;

-- Assure adequate supplies and logistical management of health care; improve the quality of education; provide family planning and improved housing and community services;

Conditionality Issues

-- El Salvador's IMF standby expired at year-end 1982; the Magana government was unwilling to commit to a new pact during its last months in office. The Duarte government has indicated readiness to begin talks on a new standby after March elections.

-- FY 84 Supplemental ESF was conditioned on a timetable by which 40 percent of total import/export transactions would be moved to the parallel market, the exchange rate unified, a high level economic analysis group formed, and a GOES request to the IMF to begin standby discussions. Suspension of disbursements may be considered if these conditions are not fully met.

-- Conditionality on FY 85 ESF may include a comprehensive adjustment package or several key elements, e.g., adjustable exchange rate system, decreased fiscal deficit, reduction of regulatory and legal constraints to investment, agrarian reform, and conclusion of an IMF standby arrangement.

-- Additional CCC and PL 480 assistance may be linked to elements of our conditionality strategy.

Basic Economic Facts

	Units	1982	1983	1984(Est.)
Gross Domestic Product	$Bn	3.35	3.81	4.36
GDP Per Capita	$US	650	770	872
Real GDP	%Ch	-5.6	0.0	1.6
Real GDP Per Capita	%Ch	-7.9	-2.2	-0.9
Cent Govt Balance/GDP	%	-5.9	-3.9	-5.0
Unemployment Rate	%	30	33	30
Total Publ. & Priv. Debt	$Mn	1.70	1.80	1.99
Debt Service Ratio	%	17	22	24
CURRENT ACCOUNT BALANCE	$Mn	-130.8	-74.5	-144.3
Merchandise Exports	$Mn	699.6	736.3	816.0
--Exports to U.S.	$Mn	318.8	348.0	408.0
Merchandise Imports	$Mn	883.0	891.5	1011.0
--Imports from U.S.	$Mn	266.8	342.7	376.0
TRADE BALANCE	$Mn	-183.4	-155.2	-195.0
CAPITAL ACCOUNT BALANCE	$Mn	127.8	164.7	56.6
BALANCE OF PAYMENTS	$Mn	-3.0	90.2	-87.7

U.S. Assistance Levels (millions of dollars)	FY 83 Actual	FY 84[1] Alloc.	FY 85 Alloc.	FY 86 Request
DA	58.8	64.6	74.7	89.8
ESF	140.0	210.0	195.0	210.0
PL 480	46.7	54.0	47.3	50.8
Total Economic	245.5	328.6	317.0	350.6
Housing Guarantees	N/A	5.0	0.0	0.0
CCC	25.5	22.8	26.5	N/A
Total Military	81.3	196.5	128.2	132.6

1/ FY 84 figures include FY 84 Supplemental

COSTA RICA: COUNTRY PROFILE

Primary U.S. Objectives

-- Strengthen our traditionally cooperative bilateral relationship that is a critical element in developing broad-based U.S. domestic and international support for our Central American policy.

-- Preservation of Costa Rica's democratic political institutions and social values.

-- Support Costa Rica as an effective spokesman in regional and global fora for an informal democratic regional alliance as a counterbalance to Soviet penetration.

-- Promote continuing economic reform leading to a more equitable and market-oriented economy.

-- Assure through military assistance that Costa Rica will have minimal self-defense capability against Nicaraguan aggression.

Recent Economic Performance and Prospects for Growth

-- Recession which began in the early 1980's bottomed out in 1982; GDP dropped by 9%, hitting hardest the manufacturing, construction and commercial sectors.

-- Slow recovery began in 1983, Costa Rica posted a 2.4 percent decline; the economy rebounded to 3.4 percent growth in 1984.

-- To maintain recovery Costa Rica will need to expand and diversify its exports and slow down growth of imports. Under these assumptions the economy could grow 3-4 percent in 1985.

Economic Assistance Strategy

-- ESF finances imports required to maintain production and employment. Local currency generated by ESF are primarily used as credit for private sector development and divestiture of public enterprises.

-- Combined with economic adjustment measures taken by the GOCR, ESF funds will help the government maintain reserve levels and meet conditions set under a new IMF stand-by arrangement.

-- In FY 86, AID will continue to support the government's stabilization program with ESF and PL 480 resources. Development assistance will fund industrial expansion.

Conditionality Issues

-- A $55 million IMF standby is scheduled for Board approval in March.

-- FY 84 Supplemental and FY 85 ESF are conditioned on the ongoing comprehensive adjustment program undertaken by the Monge Government and supported by the IMF program, a World Bank Structural Adjustment Loan, and commercial bank rescheduling.

-- Potential conditionality issues appear limited to prospects for suspension of tranched ESF disbursements should the GOCR be unable to maintain its obligations under the comprehensive program.

Basic Economic Facts

	Units	1982	1983	1984(Est.)
Gross Domestic Product	$Bn	2.82	3.06	3.19
GDP Per Capita	$US	1215	1300	1332
Real GDP	%Ch	-7.5	-2.4	3.4
Real GDP Per Capita	%Ch	-10.0	-3.6	1.0
Cent Govt Balance/GDP	%	-9.1	-3.4	-2.5
Unemployment Rate	%	14	16	16
Total Publ. & Priv. Debt	$Mn	3.84	4.45	5.03
Debt Service Ratio	%	54	35	31
Current Account Balance	$Mn	-234	-356	-390
Merchandise Exports	$Mn	866	870	960
--Exports to U.S.	$Mn	358.3	387.4	495
Merchandise Imports	$Mn	893	991	1090
--Imports from U.S.	$Mn	329.6	382.0	398
TRADE BALANCE	$Mn	-28	-121	-130
CAPITAL ACCOUNT BALANCE	$Mn	80	430	308
BALANCE OF PAYMENTS	$Mn	-314	74	-82

U.S. Assistance Levels

(millions of dollars)	FY 83 Actual	FY 84[1] Alloc.	FY 85 Alloc.	FY 86 Request
DA	27.2	20.9	13.8	14.4
ESF	157.0	130.0	160.0	150.0
PL 480	27.7	22.5	28.0	23.0
Total Economic	211.9	173.4	201.8	187.4
CCC	3.0	N/A	0.0	N/A
Total Military	2.6	9.1	9.2	2.7

1/ FY 84 figures include FY 84 Supplemental

GUATEMALA: COUNTRY PROFILE

Primary U.S. Objectives

-- Promote a stable, democratic government, friendly to us, respectful of human rights, capable of dealing effectively with the Marxist insurgent threat and responsive to the economic and social needs of its people.

-- Ensure that economic growth and the needs of the people, particularly the rural Indian population, are met through Guatemalan government policies, particularly concerning its utilization of external assistance.

-- Support economic reform through our economic assistance which will also assist the embryonic democratic process, and set the basis for recovery and development to enable the next GOG to better address the nation's pressing economic problems.

Recent Economic Performance and Prospects for Growth

-- Guatemalan economy grew in real per capita terms through 1980 while those of other Central American countries declined. By 1981 regional political problems and declining terms of trade reduced growth; real GDP has declined since 1982.

-- Early 1984 estimates put growth at zero to one per cent. Real per capita income in 1984 was 16 percent below that of 1980. Export earnings fell by 40 percent from 1980-83 due to depressed sugar and coffee prices.

-- Economy is likely to expand modestly in 1985, with U.S. assistance expected to grow if Presidential elections go smoothly.

Economic Assistance Strategy

-- Extension of economic development to the rural poor, particularly the Highland Indians. AID programs (DA and ESF) emphasize small farmer agricultural development and basic health, education and family planning services -- programs essential to address the rural poverty and related inequities which breed insurgency.

-- DA funds support projects and related policy reform to improve the savings and credit delivery systems which directly serve small farmer agricultural cooperatives, and promote and finance the voluntary sale of farm land from large landowners to small land-poor farmers.

-- Resumed ESF funding in FY 85 was projectized due to a restriction in the appropriation. It will be used to promote rural development, especially in the Highlands, and ESF-generated local currencies will finance domestic lines of credit for the non-traditional export sector.

Conditionality Issues

-- Guatemala fell out of compliance with its 1983-84 standby in mid-1984 due to lack of progress in the exchange rate and fiscal policy areas. GOG is unwilling to negotiate a new program until after the Presidential election.

-- Current conditionality issues in Guatemala involve primarily project design questions because of the Congressional restriction against use of ESF for balance of payments purposes. A broader issue considered in obligation of FY 85 ESF was the role of the Central Bank in the administration of U.S. funds intended for the private sector.

-- Macroeconomic conditionality, including the nature of a comprehensive adjustment program and the role of the IMF in Guatemala, will arise for obligation of FY 86 ESF if Congress does not reimpose the current restriction.

-- Linkage of CCC allocations to GOG willingness to implement comprehensive economic reform may also be at issue.

Basic Economic Facts

	Units	1982	1983	1984(Est.)
Gross Domestic Product	$Bn	8.73	9.05	9.61
GDP Per Capita	$US	1134	1146	1180
Real GDP	%Ch	-3.5	-2.8	0.8
Real GDP Per Capita	%Ch	-6.4	-5.7	-2.0
Cent Govt Balance/GDP	%	-4.7	-3.6	-4.4
Total Publ. & Priv. Debt	$Mn	2015	1960	2200
Debt Service Ratio	$Mn	15	23	28
CURRENT ACCOUNT BALANCE	$Mn	-404.6	-251.4	-340
Merchandise Exports	$Mn	1170.4	1205.0	1300
--Exports to U.S.	$Mn	335.7	371.3	N/A
Merchandise Imports	$Mn	1388.0	1487.0	1679
--Imports from U.S.	$Mn	389.3	315.3	N/A
TRADE BALANCE	$Mn	-217.6	-282.3	-379
CAPITAL ACCOUNT BALANCE	$Mn	88.5	N/A	N/A
BALANCE OF PAYMENTS	$Mn	-316.1	N/A	N/A

U.S. Assistance Levels

(millions of dollars)	FY 83 Actual	FY 84[1] Alloc.	FY 85 Alloc.	FY 86 Request
DA	12.2	18.2	40.0	33.0
ESF	10.0	0.0	12.5	25.0
PL 480	5.3	12.0	20.5	19.2
Total Economic	27.5	30.2	73.0	77.2
CCC	54.6	72.0	50.0	N/A
Total Military	0.0	0.0	0.3	10.3

1/ FY 84 figures include FY 84 Supplemental

HONDURAS: COUNTRY PROFILE

Primary U.S. Objectives

-- Support the consolidation of Honduras' new democracy, and the strengthening of its progressive political institutions.

-- Assist Honduras through a difficult period of economic adjustment, promote social equity, overcome economic stagnation and establish a sound basis for resuming sustainable, non-inflationary economic growth.

-- Encourage Honduras to continue its consistently creative and helpful role in seeking diplomatic resolution of the conflict afflicting Central America.

-- Retain Honduras' support in countering the security threat created by Soviet and Cuban support for regional subversion and the military buildup in Sandinista Nicaragua.

Recent Economic Performance and Prospects for Growth

-- Honduras maintained positive growth through 1981. Real GDP declined slightly in 1982-3, while investment declined by 40 percent over the 1981-2 period. Real per capita income in 1983 was 12 percent below 1979 peak level.

-- Real growth in 1984 is estimated by the government at 2.8 percent, stimulated by government spending backed by greater assistance by the U.S. and by aid from multilateral institutions. Government revenues posted a 20 percent gain, but the fiscal deficit rose to 12 per cent of GDP.

-- Government policies and an overvalued exchange rate continue to discourage foreign investors. The IMF forecasts slow growth throughout the decade in the absence of exchange rate reform; expected export growth of 6 percent per year is just enough to maintain constant GDP.

Economic Assistance Strategy

-- Help the GOH address serious deficiencies in foreign exchange, investment capital and development resources through trade policy liberalization and exchange system reform.

-- Encourage the GOH through a continuing policy dialogue to make needed reforms which would increase revenues, reduce expenditures and stimulate private sector production, particularly on non-traditional export goods.

-- Increase private sector participation in the development process while supporting the efforts of the GOH to provide tangible benefits to the rural population.

Conditionality Issues

-- Honduras was unable to maintain compliance with its 1983 IMF standby targets, and did not reach agreement on a replacement program during 1984.

-- The current dialogue with the GOH on economic adjustment measures to be taken in connection with FY 84 Supplemental ESF and FY 85 ESF has not yet led to agreement on a comprehensive program or major elements of such a program. The GOH and the IMF also have been unable to resume consultations toward a standby arrangement.

-- Issues now under consideration include disbursement of a portion of FY 84 Supplemental ESF funds based on the measures so far agreed upon in the USG-GOH dialogue, degree of conditionality on the remaining Supplemental ESF, and timimg and criteria for obligation of FY 85 ESF.

-- Conditionality on CCC guarantees and PL 480 may also be coordinated with our overall economic reform strategy.

Basic Economic Facts

	Units	1982	1983	1984(Est.)
Gross Domestic Product	$Bn	2.80	3.00	3.19
GDP Per Capita	$US	708	735	771
Real GDP	%Ch	-1.8	-0.5	2.8
Cent Govt Balance/GDP	%	-10.1	-9.8	-11.5
Total Publ. & Priv. Debt	$Bn	1.90	2.00	2.10
Debt Service Ratio	%	28.0	35.0	40.0
CURRENT ACCOUNT BALANCE	$Mn	-57	-234	-396
Merchandise Exports	$Mn	677	694	738
Merchandise Imports	$Mn	765	814	956
TRADE BALANCE	$Mn	-89	-27	-182
CAPITAL ACCOUNT BALANCE	$Mn	90	114	165
OVERALL BALANCE	$Mn	-138	-39	-32

U.S. Assistance Levels

(millions of dollars)	FY 83 Actual	FY 84[1] Alloc.	FY 85 Alloc.	FY 86 Request
DA	31.2	39.3	41.5	45.0
ESF	56.0	112.5	75.0	80.0
PL 480	15.5	19.6	18.3	17.9
Total Economic	102.7	171.4	134.8	142.9
Housing Guarantee	N/A	25.0	0.0	0.0
CCC	7.0	3.0	3.0	N/A
Total Military	37.3	77.8	62.5	88.2

1/ FY 84 figures include FY 84 Supplemental

BELIZE: COUNTRY PROFILE

Primary U.S. Objectives

-- Strengthening democratic government; Belize became independent in 1981 and held its first general elections in late 1984.

-- Encouraging settlement of the border dispute between Belize and Guatemala. Support the presence of the British garrison in Belize as essential to stability in the area.

-- Combatting drug production; Belize is estimated to be the US's fourth largest supplier of marijuana.

-- Assisting sound economic development through implimentation of the IMF standby program.

Recent Economic Performance and Prospects for Growth

-- After average annual GDP growth of 4.5 percent from 1960-80, the economy crashed in 1981-2; terms of trade declined by 25%

-- Real growth was 1 percent in 1981, and declined 6 per cent in 1982. The 1982 devaluation of the Mexican peso sharply reduced commercial earnings from foreign products resold abroad.

-- The economy recovered with slightly positive growth of 1-2 percent in 1983-4, with foreign investment increasing sharply in 1984.

-- If the government complies with their IMF agreement and continues to promote foreign investment and private enterprise, Belize could return to 4-5 percent annual GDP growth within two years and regain its 1980 peak by 1988.

Economic Assistance Strategy

-- Helping Belize to diversify its economy, develop an infrastructure, improve basic health and social services and manage its domestic and foreign debt.

-- Over the near term, AID's economic assistance will be targetted on fiscal stabilization, agriculture production and diversification, improved health services, and manpower training.

Conditionality Issues

-- Belize is currently in compliance with a 16-month IMF agreement approved in December 1984. Our ESF conditionality involves efficiency improvements in the electric power sector, better resource allocation, and reform or divestiture of the state marketing board.

Basic Economic Facts

	Units	1982	1983	1984(Est.)
Gross Domestic Product	$Mn	166.2	175.9	184.7
GDP Per Capita	$US	1,093	1,142	1,176
Real GDP	%Ch	-5.7	2.0	2.0
Real GDP Per Capita	%Ch	-8.2	-0.3	+0.1
Cent Govt Balance/GDP	%	-9.6	-7.7	-6.0
Unemployment Rate	%	N/A	N/A	N/A
Total Publ. & Priv. Debt	$Mn	N/A	N/A	N/A
Debt Service Ratio	%	5.4	8.4	7.1
CURRENT ACCOUNT BALANCE	$Mn	-18.4	-11.0	-15.8
Merchandise Exports	$Mn	59.8	65.1	70.0
--Exports to U.S.	$Mn	27.9	28.3	
Merchandise Imports	$Mn	114.2	110.3	117.4
--Imports from U.S.	$Mn			
TRADE BALANCE	$Mn	-54.4	-45.2	-47.4
CAPITAL ACCOUNT BALANCE	$Mn	18.2	2.0	9.7
BALANCE OF PAYMENTS	$Mn	-0.2	-4.3	-6.5

U.S. Assistance Levels

(millions of dollars)	FY 83 Actual	FY 84[1] Alloc.	FY 85 Alloc.	FY 86 Request
DA	6.7	5.4	6.0	6.8
ESF	10.0	10.0	4.0	4.0
PL 480	0.0	0.0	0.0	0.0
Total Economic	16.7	15.4	10.0	10.8
Total Military	0.1	0.6	0.6	1.1

1/ FY 84 figures include FY 84 Supplemental

PANAMA: COUNTRY PROFILE

Primary U.S. Objectives

-- Ensure unimpaired exercise of U.S. rights and responsibilities under the Panama Canal Treaties and related agreements.

-- Support constitutional civilian rule, and sound economic growth and development, to sustain a social, economic and political environment conducive to U.S. objectives and resistent to instability, social unrest and Communist penetration.

-- Promote comprehensive structural economic adjustment to overcome economic stagnation by diversifying the economy.

-- Enhance the ability of Panama's military to relieve the U.S. of exclusive responsibility for Canal defense, contribute to national economic and political development and maintenance of civil liberties and order; and facilitiate Panama's contribution to preservation of regional peace and security.

-- Develop necessary conditions for Panama's cooperation in studies and preparations for exploitation of Panama's geographic location after termination of the Canal Treaty in 1999, including continued U.S. military access in Panama at that time.

-- Ensure Panamanian support for U.S. policies and objectives in Central America.

Recent Economic Performance and Prospects for Growth

-- Services earnings compensated for a falloff in primary product exports to give the Panamanian economy a boost during 1979-80 while other countries entered recession. In 1981-2 construction projects boosted annual GDP growth to over 4 percent.

-- Panama's economy experienced sharp recession in 1983 when the government could no longer obtain adequate external financing to compensate for a sharp drop in private sector consumption. In 1983 total investment dropped by 21 percent . In 1984 government spending fell and the economy contracted nearly 2 percent.

-- The newly elected government faces a serious financial crisis and a split between the executive and the legislature as to its solution. Panama's use of the dollar limits monetary policy options; the government's inability to obtain increased external financing has strained the liquidity of the national bank.

Economic Assistance Strategy

-- Stimulate rapid and sustained economic growth by encouraging the government to carry out economic policy reforms and by providing financing to the private sector; assist the government to carry out its stabilization program; revitalize the construction sector through policy reform and financial assistance; and strengthen the democratic system.

-- Promote through U.S. assistance economic policy adjustments and economic stabilization, aid small business development, provide low-income housing, generate employment, and fund ongoing agriculture and rural development projects.

Conditionality Issues

-- Panama remained in compliance with an IMF agreement that expired at end 1984. A new agreement will be linked to GOP control and reduction of its burgeoning fiscal deficit.

-- The conditionality issues which may arise this year will likely depend on Panama's success in grappling with its fiscal problem and maintaining agreements with the IMF and IBRD.

Basic Economic Facts

	Units	1982	1983	1984(Est.)
Gross Domestic Product	$Bn	4.21	4.27	4.32
GDP Per Capita	$US	2147	2133	2176
Real GDP	%Ch	4.7	-1.7	-2.0
Real GDP Per Capita	%Ch	3.7	-2.7	-3.0
Cent Govt Balance/GDP	%	-11.0	-5.8	-6.2
Unemployment Rate	%	18	20	20
Total Publ. & Priv. Debt	$Bn	4.61	4.86	5.11
Debt Service Ratio	%	40	30	34
Current Account Balance	$Mn	-439	-185	-270
Merchandise Exports	$Mn	488	437	428
--Exports to U.S.	$Mn	135	160	N/A
Merchandise Imports	$Mn	1497	1353	1302
--Imports from U.S.	$Mn	477	393	N/A
TRADE BALANCE	$Mn	-1009	-916	-874
CAPITAL ACCOUNT BALANCE	$Mn	80	430	308
BALANCE OF PAYMENTS	$Mn	-359	245	38

U.S. Assistance Levels

(millions of dollars)	FY 83 Actual	FY 84[1] Alloc.	FY 85 Alloc.	FY 86 Request
DA	6.2	15.0	20.0	22.6
ESF	0.0	30.0	20.0	40.0
PL 480	1.0	1.3	0.0	0.0
Total Economic	7.2	46.3	40.0	52.6
Housing Guarantees	N/A	0.0	0.0	25.0
Total Military	5.4	13.5	10.6	19.1

1/ FY 84 figures include FY 84 Supplemental